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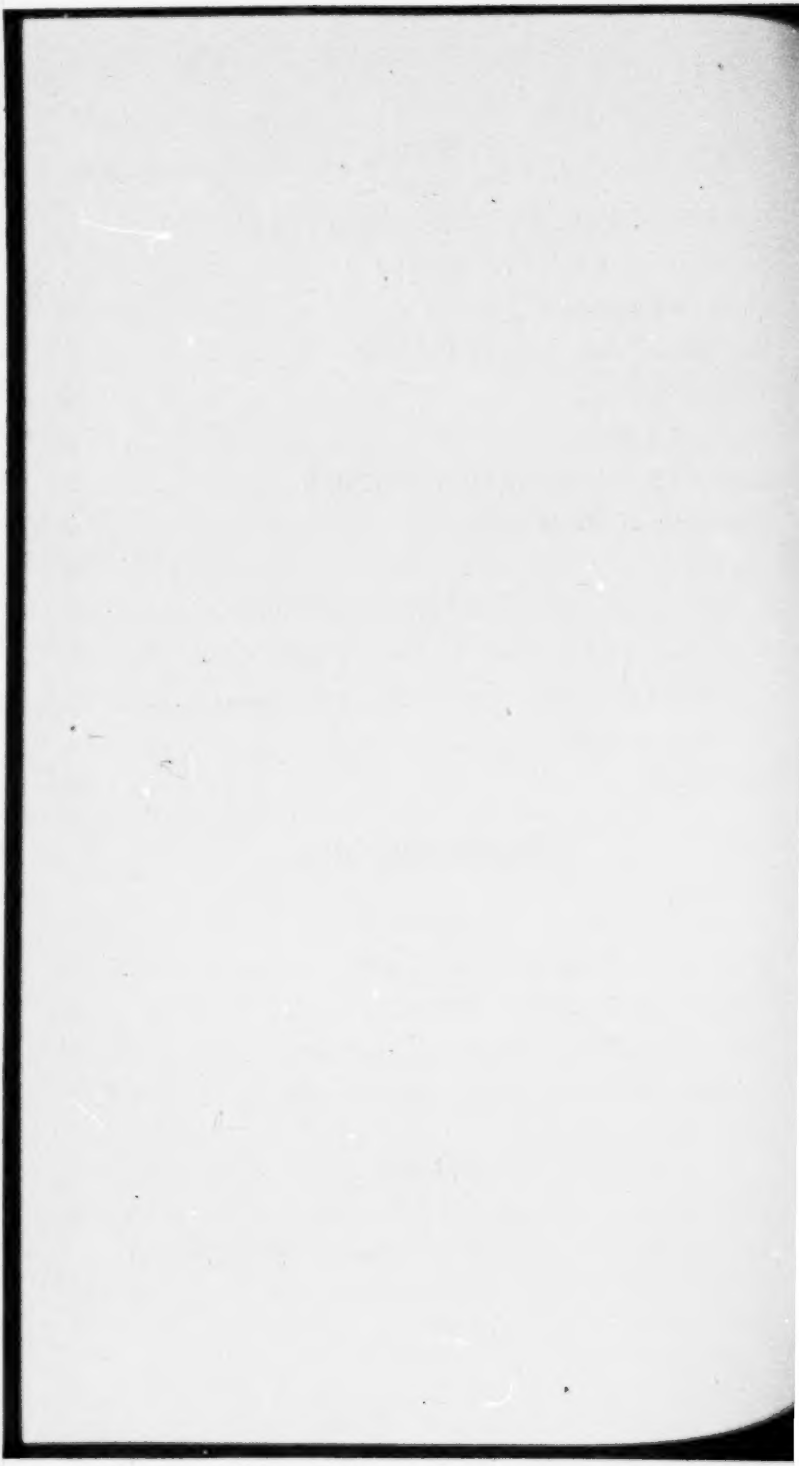

In the Supreme Court of the United States

OCTOBER TERM, A. D. 1947.

No. . . . . .

In the Matter of
THE HIGBEE COMPANY,
Debtor.
} BANKRUPTCY No. 36,119.

ROBERT R. YOUNG,
Petitioner,
v.
JOHN P. MURPHY and
GERTRUDE BAKER BRADLEY and ALVA BRADLEY,
Executors of the Estate of Charles L. Bradley, deceased,
Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, The Chief Justice and the Associate Justices of the United States:

Petitioner, Robert R. Young, hereby petitions for the issuance of a Writ of Certiorari to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit, whose judgment of December 2, 1947 affirmed the judgment below.

STATEMENT OF THE MATTER INVOLVED.

This controversy arises out of the corporate reorganization proceedings of The Higbee Company pursuant to Chapter X of the Bankruptcy Act. Petitioner is now and was, at the time of the transaction involved, a stockholder of The Higbee Company, Debtor.

At the times complained of herein, Charles L. Bradley was living. For convenience, we will refer to John P. Murphy and Charles L. Bradley as the respondents, rather than Murphy and the executors of Bradley's estate.

In June, 1937, Bradley and Murphy purchased from Ball Foundation for $60,000 cash and their limited liability note for $540,000, certain claims against and securities of The Higbee Company (R. 30). The claims were a participation in Higbee's Senior Bank Indebtedness and all of Higbee's Junior Indebtedness. The securities were the entire issue of common stock. Later, under the Plan of Reorganization, respondents received the avails of these Higbee securities. Briefly they were: $69,673.71 in cash, $600,000 of new Higbee 4% notes (since paid in full) and about 51% of the new Higbee common stock. At the time of this purchase, Bradley was a director of Higbee. Murphy became a director a month later (R. 119, 121). Shortly afterwards Bradley was elected president. Higbee had been in bankruptcy reorganization proceedings since August, 1935. The debtor was in possession of its property (R. 98). Bradley retained his official position until his death on December 18, 1943 (R. 43, Paragraph 6 (c)). Thereafter, Murphy became president. He still holds that office.

In 1941, the District Court entered a judgment confirming the Plan of Reorganization for Higbee which awarded to Bradley and Murphy the Higbee securities (R. 136). Prior to that time, some of the Higbee shareholders had objected to respondents' obtaining so large an award from the reorganization and had questioned the propriety of officers of the debtor company dealing for their personal gain in the bankrupt's obligations and securities (R. 93, 133).

J. Fred Potts and William W. Boag between them owned 260 shares of the old preferred stock of Higbee. They were members of a Preferred Stockholders Committee. Potts was also the attorney for the committee.

They had appealed on behalf of all said stockholders to the Sixth Circuit Court of Appeals from the order of the District Court confirming the Higbee Plan of Reorganization (R. 141). Before the Circuit Court heard the appeal, Bradley and Murphy, on March 7, 1942, bought the 260 shares of stock owned by Potts and Boag, together with the "right" to dismiss the appeal (R. 44, 45). They paid $115,000.00 for stock worth about $17,000.00 on the market (R. 7). Bradley and Murphy forthwith caused the dismissal of the appeal and consequent final confirmation of the Plan of Reorganization (R. 14). In that manner, respondents, while holding official positions in the debtor company, removed the risk of losing all or part of the new Higbee securities which under the Reorganization Plan were awarded to them personally.

Petitioner contends that this transaction is wrongful because it was done for personal advantage by persons occupying a fiduciary capacity, thereby depriving their beneficiaries, Higbee stockholders, of a legal adjudication which, if successful, would award the beneficiaries a substantial sum (R. 121). In this case petitioner sought an order requiring respondents to account to all the shareholders of Higbee for what respondents had gained as a result of their purchase and consequent dismissal of the Potts and Boag appeal (R. 2). The District Court held that respondents need not account for their personal gain (R. 279). The avails to respondents at the time of hearing the instant case in the District Court, had a market value of $3,637,475, calculated at per share prices stipulated by counsel for respondents (R. 41, 42). The Circuit Court affirmed the District Court (R. 289).

In earlier litigation in these same reorganization proceedings (*Young v. Higbee Co., et al.*, 324 U. S. 204 (R. 5)), the Supreme Court reversed the lower courts to hold Potts and Boag accountable to Higbee preferred stockholders

for what they had gained (less than $100,000.00) as a result of their part in this same wrongful transaction.

The Higbee reorganization plan has been finally confirmed by proper legal authority and is in operation. In the courts below, petitioner affirmatively stated that he was not attempting to reopen the reorganization plan. Nevertheless, the Circuit Court has determined that to require respondents to account for their personal gains, derived from trafficking in Higbee securities while in bankruptcy and while they held official positions in the debtor company, would necessarily have that effect. In its opinion in this case, the Circuit Court said (R. 290, 291):

> "It is obvious that to grant the relief sought by Young would require the setting aside of the plan of reorganization of The Higbee Co. confirmed by the district court whose judgment was affirmed on appeal by this court."

Notwithstanding this statement by the Circuit Court, the fact is clear that the District Court's judgment was "affirmed" only in the sense that it was allowed to stand as a result of the dismissal of the appeal. That judgment was never affirmed after consideration. And, since the consideration was prevented by the wrongful act of respondents in buying the appeal, they should be estopped to receive any benefit from the contention that the confirmation of the Reorganization Plan was a final adjudication of the issue raised by this case.

Furthermore, the petition did not ask to set aside the Plan of Reorganization, nor did it ask for any change whatsoever in that Plan except that the New Higbee securities allowed by the Plan to Bradley and Murphy, in excess of their cost of acquisition, should be decreed to be held in trust for the benefit of all stockholders (R. 3, 4).

The accounting prayed for in the petition is supported by two considerations. Potts and Boag brought an appeal concerning the Reorganization Plan for the benefit of all

stockholders, and thereby placed themselves in a fiduciary position, as has already been held by the Supreme Court. This position they could sell only subject to those obligations. But even had Potts and Boag been free to deal with the stock and the appeal as they pleased, the very acquisition of these rights by Bradley and Murphy imposed a trust because of their position as officers and directors of the debtor in possession of its property in reorganization proceedings.

This action was commenced by petitioner in a representative capacity for the benefit of all Higbee stockholders (R. 2). The Circuit Court did not pass on the merits of this petition because it erroneously held that there had been an adjudication of the same issues between the same parties. It used the following language (R. 291, 292):

> "Young and his associate, Kirby, appealed from the final judgment entered in this case on March 16, 1943. On April 21, 1944, this court affirmed that judgment. See *Young v. Bradley,* 142 F. (2d) 658 (C. C. A. 6). It would seem to be unnecessary and inappropriate to repeat here what was said in that opinion. As we see it, the present petition of Young seeks to reopen a matter already finally adjudicated against him in the previous opinion and decree of this court, affirming that of the district court. There has been an adverse final judgment entered against him on the same issues and questions which Young presents by his present petition. There is no difference in the alignment of the parties; Young on the one side; Bradley and Murphy on the other."

The earlier litigation referred to was commenced by Young and Allan P. Kirby about June 3, 1941, by filing proofs of claim in these proceedings (R. 56, Paragraph 4). Midamerica Corp. (the name of which was later changed to Terminal & Shaker Heights Realty Co.) and Frank F. Kolbe were also claimants in that controversy. But what gave rise to the present action, namely the purchase by respondents

of the "right" to dismiss the Potts and Boag appeal, did not occur until nine months after that date.

In the earlier case, Young, Kirby, Kolbe and Midamerica were claimants in their own right and for their own benefit. In this case, Kirby, Kolbe and Midamerica are not parties and Young claims nothing for himself, but only as a stockholder suing for the benefit of all Higbee stockholders.

In the earlier case, the petitioners sought to charge Bradley and Murphy as trustees because of their personal obligations to petitioners, and it was immaterial that respondents were officers of the Higbee Co. In the present case it is sought to enforce a trust relationship against Bradley and Murphy as officers and directors of a debtor corporation in reorganization proceedings, and their personal obligations to Young and associates are immaterial here. The Circuit Court's complete confusion of the issues presented and the relief sought in the instant case is the error of which complaint is here made.

Beyond the question involved in the above described error of the Circuit Court in deciding that Young's suit as a stockholder in a representative capacity was *res adjudicata*, because of a prior judicial determination against Young and three others, seeking for their own benefit to hold Bradley and Murphy as trustees for them with respect to the purchase of certain securities on the theory that respondents owed a personal fiduciary obligation to the claimants, the issue may be stated in a single paragraph:

QUESTION PRESENTED.

Should corporate officers and directors who purchased securities of their corporation while it was a "debtor in possession" in Chapter X reorganization proceedings and under their control, and who protected their position under a reorganization plan which allowed them large profits by buying the stock of persons who had ap-

pealed from the District Court order approving the plan and then dismissing the appeal, thereby making the plan effective, be required to account as fiduciaries to all stockholders for their profits from such transactions without reopening the reorganization plan, and should the decision of the Circuit Court of Appeals that such accounting would necessitate reopening the plan be reviewed and reversed?

REASONS FOR ALLOWANCE OF THE WRIT.

This case presents a question concerning the right of officers of a company in bankruptcy reorganization to traffic in the securities of that company acquired during the course of the reorganization, and further to traffic in the reorganization proceedings themselves by buying the right to dismiss an appeal which criticized the general award in favor of the officers. The other and lesser aspect of this problem arising from the very same transaction was recognized by the Supreme Court as a question of paramount importance to the fair conduct of reorganization proceedings. We refer to the judgment of the Supreme Court and the opinion of the Court written by Mr. Justice Black in *Young v. The Higbee Co.*, 324 U. S. 204 (R. 5).

The decision of the lower courts in this case permits corporate officers to advance their own personal interests at the expense of the stockholders whom they have a general duty to protect, plus a particular duty while the company is in reorganization to use the processes of bankruptcy and the courts for the benefit of the creditors rather than for their personal gain. This subject is of paramount importance to the fair conduct of corporate reorganization proceedings.

JURISDICTION.

The jurisdiction of this Court to grant the Writ is invoked under Judicial Code Section 240 as Amended (Title 28 U. S. C. A. Section 347). The judgment of the United States Circuit Court of Appeals for the Sixth Circuit was rendered December 2, 1947, and this petition is filed within the statutory period (U. S. C. A. 350).

PRAYER FOR RELIEF.

WHEREFORE the petitioner, by his counsel, prays the issuance of a Writ of Certiorari to the U. S. Circuit Court of Appeals for the Sixth Circuit to the end that the judgment may be reversed and for such other relief as to the Court may seem appropriate.

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ROBERT W. PURCELL,
Attorneys for petitioner,
Robert R. Young.

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JOHN P. MURPHY and
GERTRUDE BAKER BRADLEY and ALVA BRADLEY,
Executors of the Estate of Charles L. Bradley, deceased,
Respondents.

BRIEF IN SUPPORT OF PETITION.

STATEMENT OF FACTS.

The Higbee Company, a large department store in Cleveland, Ohio, filed a petition under Section 77B of the Bankruptcy Act on August 9, 1935 (R. 98). It remained in bankruptcy reorganization under the jurisdiction of the U. S. District Court at Cleveland until December 1, 1942 (R. 165). The Securities and Exchange Commission made an extensive report on the proposed Plan of Reorganization of Higbee (R. 96). This disclosed a capital structure as of January 31, 1941, of a total Senior Indebtedness amounting to $1,439,000, a Junior Indebtedness of $1,952,000, first preferred stock of $1,878,000, second preferred stock of $783,000 and 100,000 shares of common stock (R. 99).

In 1937, Bradley and Murphy purchased from the George and Frances Ball Foundation a participation in the Senior Indebtedness in the amount of $69,673.71, the entire Junior Indebtedness and the entire issue of common stock. They agreed to pay $600,000 for these Higbee securities. They did pay $60,000 cash and executed a note to the Ball Foundation for the balance (R. 231, paragraph 11), collectible only out of the collateral and carrying no personal liability of the makers. Shortly thereafter, Bradley became president and Murphy was elected a director of Higbee.

In exchange for the Higbee securities which Bradley and Murphy had purchased from the Ball Foundation, the Reorganization Plan allotted Bradley and Murphy the full participation of $69,673.71 in the Senior Indebtedness to be paid in cash, $600,000 of new 4% notes and 51% of the new common stock (R. 102). At this time respondents had a total cash investment of only $60,000 in the Higbee securities, offset by the collection of $69,673.71 in cash. The note to the Ball Foundation in the sum of $540,000 was still unpaid, but carried no personal liability of the makers.

This very liberal award to the respondents who had "devoted their time and effort to * * * the development of a Plan of Reorganization * * *" (R. 232, paragraph 14), naturally caused some of the preferred stockholders to object. The Potts and Boag appeal on behalf of preferred stockholders against the confirmation of the Plan complained that the Ball Foundation had paid only $100,000 when it purchased the Higbee securities; that respondents had agreed to pay only $600,000 when they bought the securities from the Ball Foundation; and, that the Junior Indebtedness was invalid and unenforceable (R. 134).

On March 7, 1942, when Bradley was president and a director of Higbee and Murphy was also a director (R. 13), respondents purchased from Potts and Boag for $115,000

(R. 13, 44), their 260 shares of Higbee preferred stock which had a market value of about $17,000 (R. 7). With the purchase of the stock, by the specific terms of the agreement, respondents acquired the "right" to dismiss the appeal which had been filed by Potts and Boag. On March 9, 1942, respondents filed a stipulation in the Sixth Circuit Court of Appeals to dismiss the Potts and Boag appeal. On March 11, 1942, the Circuit Court did dismiss the appeal (R. 14, paragraph 4). These legal steps automatically confirmed the Reorganization Plan.

On December 18, 1943, Charles L. Bradley died. His executors were appointed by the Probate Court of Cuyahoga County and qualified on December 23, 1943. Bradley and Murphy had filed claims of title to the Higbee securities and the avails thereof in reorganization. Bradley's executors entered appearance in these Higbee reorganization proceedings when the actions were revived against them in the Circuit Court on February 23, 1944 (R. 39). In November, 1944, the Higbee securities were delivered to Bradley's estate and Murphy. At the time of hearing the instant case in the District Court these securities had a value of $3,637,475 calculated at prices per share stipulated by counsel for respondents (R. 41, 42). The District Court, however, retained jurisdiction over the final disposition of the Higbee securities. In the final decree of discharge, the court said (R. 167):

> "V. That this Court hereby retains jurisdiction of the proceedings in this cause solely for the purpose of hearing and determining the following matters:
>
> (a) * * * together with any and all matters relating to said new note, said new common stock and said participation in said proceeds, including the escrow with The Cleveland Trust Company established by order entered on August 21, 1942. * * *"

(These are the Higbee securities referred to herein.)

ARGUMENT.

Respondents Should be Held Accountable.

In previous litigation the Supreme Court held that Potts and Boag were accountable to the preferred stockholders of Higbee for what they received from their "sale" of the appeal to respondents. The basis of the decision, 324 U. S., 204 (R. 5), is that the bankruptcy law is intended to bring about a ratable distribution among creditors and to protect the creditors from one another. The Supreme Court laid down the rule that claimants in bankruptcy reorganization utilizing the rights afforded under the bankruptcy law were responsible to their class of claimants to act in good faith and could not profit above their class by trafficking in bankruptcy litigation. We quote from the opinion of the Supreme Court (R. 9):

> "We are now asked to say that the privilege of appeal granted to Potts and Boag by the Act, vested them with an indefeasible right to sell the privilege to the disadvantage of all other stockholders in their class. But, historically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another. And the corporate reorganization statutes look to a ratable distribution of assets among classes of stockholders as well as creditors. There would be no ratable distribution of this bankrupt estate if Potts and Boag could utilize their statutory right of appeal to get for their preferred stock $7.00 for every $1.00 paid to other preferred stockholders. We are asked to say that Congress intended such a consequence, and to construe the right of a stockholder to be heard on a plan of reorganization as carrying with it the right to 'sell' the very appeal which the Act grants him.
>
> Potts and Boag, by appeal from a judgment which affected a whole class of stockholders owed an obligation to them, the full extent of which we need not now delineate. Certainly, at the very least they owed them an obligation to act in good faith."

Bradley and Murphy were the largest creditors in the Higbee reorganization proceedings. They had bought from the Ball Foundation a participation in the Senior Indebtedness, the entire Junior Indebtedness and all of the common stock. As individuals they had more at stake than any other creditor. In their official capacity as directors, and Bradley as president of Higbee, as developers of the Plan of Reorganization, they owed a fiduciary obligation to all Higbee creditors. Can it be said that the obligation of these directors towards Higbee stockholders is less than that owed by Potts and Boag, who held no official position, but were merely complaining stockholders?

Potts and Boag have been held to have no right to sell an appeal. They have been found to owe an obligation to act in good faith towards their fellow stockholders, so that they all might rate equally. Corporate directors who "bought" the Potts and Boag appeal with the intention of dismissing it, thereby to confirm the Reorganization Plan and to obtain for themselves securities worth several million dollars, for which they had paid but $60,000 in cash, certainly, at the very least, owed an obligation to all Higbee stockholders to act in good faith.

Respondents, of necessity, were abusing the bankruptcy law which was intended to bring about a ratable distribution among the creditors and to protect the creditors from one another. There was no ratable distribution of this bankrupt estate. Bradley and Murphy realized $50.00 for every $1.00 of cash invested by buying the bankrupt securities during the reorganization proceedings, and then concluding the reorganization to their advantage by buying the appeal which questioned their participation in the avails of the reorganization.

It is well established law that corporate officers may not use their position for their own personal gain to the detriment of stockholders of the company. See *Pepper v. Litton*, 308 U. S. 295 at 311. Respondents cannot shake off

their responsibilities to Higbee stockholders by trading in the rights of these stockholders for respondents' own aggrandizement. We quote from the Supreme Court opinion re Potts and Boag (R. 11):

> "To hold that the Chandler Act permits this, would be to say that Congress, which sought more effectively to accomplish fair and equitable treatment of investors, had by granting a right of appeal to stockholders, defeated its purpose, and had substantially modified the whole body of law imposing the most rigorous responsibilities for fair dealing upon those who represent the rights of others. (Cf. *Woods v. City Bank*, 312 U. S., 262, 267-269; *Meinhard v. Salmon*, 249 N. Y. 458.)"

Bradley and Murphy as senior officers of Higbee represented all stockholders and were obliged further, as officers of the debtor company in possession of its property, by permission of the Bankruptcy Court, to represent the interests of all creditors of Higbee. Judge Cardozo in writing the opinion in *Meinhard v. Salmon*, 249 N. Y. 458, said:

> "Many forms of conduct permissible in a work-a-day world for others acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. *Wendt v. Fischer*, 243 N. Y. 439, 444, 154 N. E. 303. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this Court."

Accounting Does Not Reopen Reorganization Plan.

The Circuit Court thought it desirable that this Higbee litigation be terminated. That Court, in effect, held it was more important that nothing be done to disturb the Reorganization Plan, than to hold respondents accountable for their personal profits made from actions taken in their official positions in the reorganization proceedings. An end to litigation is always desirable. However, principle comes ahead of expediency. Even so, there is no conflict between the completion of the Higbee reorganization and the accountability of respondents.

The Supreme Court found that Potts and Boag were accountable to the preferred stockholders of Higbee. This accountability in no manner disturbed the finality of the Reorganization Plan. Likewise, the accountability of Bradley and Murphy to the Higbee Co. for what they received as the result of "buying" the Potts and Boag appeal need not disturb the finality of the Reorganization Plan. The Higbee Co. has been operating as a private corporation, free of control by the Bankruptcy Court, since December 1, 1942. If respondents should be found to owe to the Higbee Co. all or part of the more than three million dollars profit they made from trading in Higbee securities and appellate litigation during bankruptcy, that fact could hardly injure the credit of the company or the rights of its stockholders, so as to cause it to go back into bankruptcy.

Petitioner's Claim Is Not Res Adjudicata.

There can be no doubt that the Circuit Court erred in holding that the issues in the instant case were decided adversely to the petitioner in *Young v. Bradley,* 142 F. (2d), 658 (C. C. A. 6). That decision, as an examination of the printed opinion shows, related to the several claims of Young, Kirby, Terminal and Shaker Heights Realty Co. and Kolbe, that they were owners of the Higbee securities purchased from the Ball Foundation. Those claims were

based upon the assertion that Bradley and Murphy owed fiduciary obligations to the claimants because of relationships established in 1937. Young and Kirby filed their claims June 3, 1941, nine months before Bradley and Murphy bought the Potts and Boag appeal, March 7, 1942, and a month prior to the date the District Court first approved the Reorganization Plan on July 2, 1941.

The instant case is a representative action brought by petitioner on behalf of all Higbee stockholders, complaining of the profits made by respondents as a result of their "buying" the Potts and Boag appeal, thereby finally confirming the Reorganization Plan. This case has no relation to the prior claim filed by Young for his personal benefit, which was decided adversely to him by the Circuit Court in 142 F. (2d) 658. The adverse judgment against Young in that case is final. But the issues and questions there presented by Young are not the same as those raised in this representative action.

Opinions Below.

The opinion of the District Court was not published. It appears in the Record at page 268. The extensive order of the District Court in conformity with the opinion appears in the Record at page 271. The opinion of the Circuit Court of Appeals is found in the Advance Sheets of Federal Reporter, Second Series, for January 19, 1948. The citation is 164 F. (2d) 426. It appears in the Record at page 290.

CONCLUSION.

WHEREFORE, Petitioner respectfully prays the issuance of a Writ of Certiorari.

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